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Bernanke Says Fiscal Stimulus Could Revive Expansion

By Craig Torres and Scott Lanman

Jan. 17 (Bloomberg) -- Federal Reserve Chairman Ben S. Bernanke said fiscal stimulus of as much as $150 billion would help revive economic growth, while warning against any widening of the budget deficit in coming years.

Bernanke's acknowledgment that the economy is weak enough to need stimulus validates forecasts that the Fed will lower interest rates by at least half a percentage point this month. President George W. Bush will tomorrow lay out the general principles he favors for a short-term stimulus, Deputy Press Secretary Tony Fratto said today.

A temporary package of at least $60 billion to $70 billion in spending by early 2009 would have a ``significant'' effect in the second half of this year, Bernanke said.

``It would certainly be measurable, it would not be window dressing,'' he told the House Budget Committee in Washington today in response to a question.

He repeated remarks from last week that the Fed is ready to take ``substantive additional action'' on interest rates to insure against risks of a recession. Treasury notes rallied and the dollar dropped after Bernanke's remarks and a report from the Fed's Philadelphia branch showing manufacturing shrank.

``Support of a temporary fiscal stimulus suggests great concern on Bernanke's part about the downside risks,'' said Robert Eisenbeis, a former research director at the Atlanta Fed. ``He certainly doesn't want to be held responsible for a recession, even though the seeds were laid'' in final years of former chairman Alan Greenspan's tenure, he said.

Rebate, Business Breaks

The Bush administration is close to completing an economic- stimulus proposal that will include $800 rebates for individuals and $1,600 for households as well as tax breaks for businesses, people familiar with the plan said today.

Bernanke warned that a fiscal package could also ``prove quite counterproductive'' if it arrived at the ``wrong time or compromised fiscal discipline in the longer term.''

Bernanke reiterated that the outlook for growth in 2008 has worsened and ``the downside risks to growth have become more pronounced.'' He said the Fed isn't forecasting a recession this year.

Retail sales fell last month, unemployment rose, and housing markets are mired in the worst slump in 16 years.

Bernanke noted that banks are trying to protect asset quality and funding, and tightening credit conditions for the rest of the economy as a result.

``Banks have also evidently become more restrictive in their lending to firms and households,'' he said. ``More expensive and less-available credit seems likely to impose a measure of restraint on economic growth.''

Housing Starts Tumble

Homebuilders broke ground on the fewest homes since 1991 last month, the Commerce Department reported today. Building permits, a sign of future construction, declined by the most in 12 years, suggesting the housing slump will deepen.

Residential construction subtracted about 1 percent from growth in the third quarter, and likely curtailed growth even more in the fourth quarter, Bernanke said. Sluggish housing markets ``may continue to be a drag on growth for a good part of this year.''

Bernanke said inflation, both including and excluding food and energy costs, ``should moderate this year and next, so long as the public's confidence in the Federal Reserve's commitment to price stability is unshaken.'' He cited inflation expectations that appear ``well anchored'' and futures suggesting food and energy price increases will slow.

Split With Greenspan

Bernanke, as in past congressional appearances, avoided recommending any particular tax measure or spending program. His predecessor, Alan Greenspan, involved himself in shaping tax policy, recommending cuts over spending increases in 2001, a strategy which his colleagues disliked out of concern it would compromise the central bank's independence.

The chairman's speech ``is an endorsement of temporary measures, if enacted quickly, but he's covering himself to ensure he is not blamed for anything in a few years, the way Greenspan is now blamed for endorsing the Bush tax cuts,'' said Ian Morris, chief U.S. economist at HSBC Securities USA Inc.

Aside from quick implementation, a stimulus package should also be ``structured so that its effects on aggregate spending are felt as much as possible in the next 12 months,'' Bernanke said today. If stimulus comes at a time when growth is improving, it could be ``destabilizing,'' he said.

Bernanke Guidance

While Bernanke stressed that it's up to elected lawmakers to decide on tax and spending proposals, he did offer advice on the types of measures that may be more effective. He urged that they ``diversify'' the components to broaden the impact.

There is the most ``bang for the buck'' from transferring funds to lower- and middle-income workers because they are more likely than the wealthy to spend the money quickly, Bernanke said. Tax rebates in 2001 helped bolster consumer spending and prevent a deeper recession, the Fed chief said.

Turning to corporate taxes, Bernanke said incentives for investment in software and equipment would be more effective than a cut in the corporate tax rate. He suggested that the rate is more a question for the longer term.

Bernanke declined to comment directly when asked by Republican legislators whether he favors making permanent the 2001 and 2003 tax cuts scheduled to expire in 2010. At the same time, he said that making dividend-tax cuts permanent could have a short-term impact on financial markets.

While stating that tax cuts ``don't generally pay for themselves'' and urging lawmakers to balance the budget, Bernanke said that for a short-term package to help the economy, it would need to widen the budget gap at least for a time.

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